

1 ROBERT S. STERN (SBN 68240)
2 W. STEPHEN SMITH (*admitted pro hac vice*)
3 GREGORY B. KOLTUN (SBN 130454)
MORRISON & FOERSTER LLP
3 555 West Fifth Street, Suite 3500
Los Angeles, California 90013-1024
4 Telephone: (213) 892-5200
Facsimile: (213) 892-5454
5 rstern@mofo.com

6 Attorneys for Defendant
JPMORGAN CHASE BANK, N.A.,
7 Successor-in-interest to BANK ONE, N.A.

8
9 UNITED STATES DISTRICT COURT FOR THE
10 NORTHERN DISTRICT OF CALIFORNIA
11 SAN FRANCISCO DIVISION

12 In re ATM FEE ANTITRUST LITIGATION

13 Civil Case No. C 04 2676 CRB

14 [REDACTED] SUPPLEMENTAL
15 DECLARATION OF RICHARD
16 SCHMALENSEE

17 Date: March 7, 2008
18 Time: 10:00 a.m.
19 Courtroom: 8

20 Relates to All Actions

21

22

23

24

25

26

27

28

1 **I. INTRODUCTION**

2 1. I have been asked by counsel to assess the economic arguments made by plaintiffs' experts. Dr. Bamberger's claim that positive interchange fees are anticompetitive is flawed for many reasons, the most significant of which are discussed in this declaration. For example:

- 5 • Dr. Bamberger asserts, without any basis, that the competitive outcome requires a zero interchange fee. Real world experience has shown that competition among ATM networks consistently results in positive interchange fees.
- 7 • Positive network-wide interchange fees are ubiquitous in the competitive world of retail banking services and ATM services in particular. Dr. Bamberger does not challenge that fact. Instead, his theory of harm is based on his views about an absence of consumer information, not an absence of competition. Consumer information problems, however, generally are addressed through regulation, not the antitrust laws.
- 11 • Dr. Bamberger's theory relies critically on assumptions that are unsupported by theory or credible evidence, particularly his assumptions that interchange fees directly and predictably affect foreign fees and that surcharges are more constrained by consumer sensitivity than are foreign fees.
- 14 • Dr. Bamberger's proposed but-for world, in which all ATM networks – whether joint ventures or proprietary – are required to set zero interchange fees, would result in significant consumer harm. There would be fewer ATMs, lower output, and greater inefficiency in ATM networks. Surcharges would be higher for consumers, with no assurance of an offsetting decrease in foreign fees.

17 2. My qualifications are as described in my prior declaration.

18 **II. Dr. Bamberger's Theory of Competitive Harm Is Flawed**

19 **A. Dr. Bamberger Asserts That the "Competitive" Outcome Requires a Zero Interchange Fee, But There Is No Theoretical or Factual Basis for That Assertion**

21 3. In my prior declaration, I explained why there is a need for advance agreement between the ATM owner and the ATM card issuer in order for foreign ATM transactions to be viable. The ATM owner needs assurance that it will be reimbursed by the issuer, and the parties need to agree on the terms of such reimbursement (*e.g.*, amount, time, manner and risk allocation). I also explained why achieving this contractual certainty through bilateral negotiations among network members would be at best inefficient and almost certainly

1 unworkable for an ATM network of the size and breadth of Star. Dr. Bamberger also agrees
 2 with both of these conclusions.¹

3 4. Although Dr. Bamberger states that he is addressing the effects of “network-
 4 mandated interchange fees,”² as an economic matter he simply is comparing network regimes
 5 with positive interchange fees to regimes with zero interchange fees. This is because there is no
 6 economic difference between network rules that explicitly state “the interchange fee shall be
 7 zero” and network rules that, by requiring only that ATM owners be paid for the cash they have
 8 disbursed plus any surcharges they have imposed, implicitly set the interchange fee at zero. In
 9 the latter case, as I explain in my original declaration, no rational issuing bank would ever pay a
 10 positive interchange fee since the network rules require all ATM owners to accept its cards
 11 regardless of whether it pays such a fee. Dr. Bamberger’s primary disagreement with my
 12 conclusions is thus over the level of the interchange fee determined at the network level.
 13 Dr. Bamberger believes that, in effect, the ATM networks should have been required to set the
 14 interchange fee at zero because “positive network-mandated interchange fees can be expected to
 15 increase the price cardholders pay for foreign ATM transactions and increase the aggregate
 16 profits of members of ATM networks as compared to a but-for world in which ATM networks
 17 do not mandate interchange fees.”³ As I discussed above, by “do not mandate interchange fees,”
 18 Dr. Bamberger means that the network does not require any party to pay a positive interchange
 19 fee, thus, given the infeasibility of bilateral negotiations, implicitly mandating an interchange fee
 20 of zero – that is, surcharges aside, if, for example, an ATM owner that pays out \$100, it will
 21 receive \$100 from the cardholder’s bank.⁴

22
 23

24¹ Deposition of Gustavo E. Bamberger, February 1, 2008 (“Bamberger Deposition”), at 26:4-
 25 27:2. Dr. Bamberger takes as an assumption in his declaration my view that bilateral
 26 negotiations would be likely unworkable. Declaration of Gustavo E. Bamberger, December
 27 21, 2007 (“Bamberger Declaration”), at fn. 1. He also stated in his deposition that he “tended
 28 to agree” with this position. Bamberger Deposition at 38:10-14.

² See, e.g., Bamberger Declaration at ¶ 2.

³ Bamberger Declaration at ¶ 59 (footnote omitted).

⁴ Bamberger Deposition at 26:24-29:6; 30:8-14.

1 5. There is no basis for Dr. Bamberger's position that "[n]etwork-mandated interchange
 2 fees can be expected to increase the price of a foreign ATM transaction above the competitive
 3 level."⁵ A natural and standard approach to assessing the "competitive level" would be to
 4 examine what level of interchange fees actually has prevailed under competition. As I explained
 5 in my prior declaration, the existence of positive interchange fees for all ATM networks,
 6 proprietary networks as well as joint ventures, in the United States at all points in time is
 7 persuasive evidence of their efficiency benefits. The undisputed competition among ATM
 8 networks has led to their independent decisions to choose positive interchange fees. These facts
 9 provide convincing evidence that, contrary to Dr. Bamberger's claim, the competitive level of
 10 interchange fees is not zero.

11 6. The fact that proprietary networks set positive interchange fees confirms that such
 12 fees are the product of competition, not an agreement to lessen competition. Proprietary
 13 networks compete intensely with each other to attract card issuers and ATM owners; they set
 14 interchange fees independently of, and in competition with, each other. Dr. Bamberger
 15 recognizes that proprietary networks, in addition to joint ventures, set positive interchange fees.⁶
 16 Thus, while he recognizes that competition among ATM networks, even proprietary networks,
 17 results in positive interchange fees, he asserts that the "competitive level" of interchange fees is
 18 zero. Dr. Bamberger's conclusion makes sense only if he is not using the term "competitive" as
 19 economists normally do.

20
 21
 22
 23
 24⁵ Bamberger Declaration at ¶ 2. Dr. Bamberger refers to a network with a zero interchange fee
 as a network without an interchange fee.

25⁶ He states that "a proprietary network can be expected to adopt policies that increase the
 26 profits of its members (*i.e.*, because such policies increase the demand for the network's
 27 services)" and hence to adopt positive interchange fees. Bamberger Declaration at ¶ 52.
 28 Absent a conspiracy among ATM networks – which he does not allege (Bamberger
 Deposition at 221:6-24) – this is simply a description of a competitive market at work. The
 reason why each proprietary network employs positive interchange is because it increases
 "the demand for the network's services" – thus increasing network profits by making it more
 valuable to both ATM owners and cardholders.

1 **B. Dr. Bamberger's Theory of Competitive Harm Is Based on**
 2 **Flawed Assumptions**

3 7. Dr. Bamberger's theory of harm is premised on consumer information, not
 4 competition, being deficient. Moreover, his theory and numerical examples rest on flawed
 5 assumptions.

6 **1. Information versus competition**

7 8. In Dr. Bamberger's theory, the setting of positive interchange fees by competing
 8 ATM networks enables competing banks to better exploit the alleged manner in which
 9 consumers respond to surcharges as opposed to foreign ATM fees. This is not a theory in which
 10 consumer harm results from restricted competition. Although Dr. Bamberger claims that
 11 positive interchange fees are anticompetitive and reflect the exercise of market power, he does
 12 not define a relevant antitrust market within which such power is exercised.⁷ He nowhere claims
 13 that banks or ATM networks compete less intensively with positive interchange fees than they
 14 would with zero interchange fees. Thus Dr. Bamberger cannot and does not allege that setting
 15 positive interchange fees almost always tends to restrict competition and decrease output.⁸

16 9. Antitrust is normally concerned with situations in which competition is restricted, not
 17 with what Dr. Bamberger alleges here – *i.e.*, that competition among banks and ATM networks
 18 does not serve consumers well because consumers lack information. Dr. Bamberger's analysis
 19 rests on the fact that ATMs display the surcharge, if any, that they would apply to a foreign
 20 transaction, but they do not display the foreign fee, if any, that the consumer's bank would
 21 charge. But if this is the problem, then an agreement between any two banks in an ATM
 22 network – even two small banks that could not possibly possess market power – to charge

23
 24
 25 ⁷ Dr. Bamberger attempts to justify his failure to define a market based on my not having done
 26 so in my declaration. But my analysis was concerned with the efficiencies associated with
 27 interchange fees, and that analysis does not require a market definition. Dr. Bamberger, in
 28 contrast, is claiming that positive interchange fees reflect an exercise of market power, and
 such a claim logically requires a discussion of the market or markets within which such
 power is claimed to be exercised.

25 ⁸ Indeed, in his deposition he admitted that output might fall in the absence of positive
 26 interchange fees. Bamberger Deposition at 180:11-12.

1 positive interchange fees will give rise to the harm Dr. Bamberger alleges.⁹ And the remedy
 2 would be for legislation or regulation to require greater disclosure of foreign fees. The fact that a
 3 rule requiring the display of foreign fees at ATMs would be a complete remedy to the problem
 4 Dr. Bamberger alleges demonstrates that it is not a problem that flows from a restraint on
 5 competition.

6 **2. Impact of interchange fees on foreign fees versus surcharges**

7 10. Dr. Bamberger argues that if all networks' interchange fees were set at zero,
 8 consumers would pay less because foreign fees for ATM transactions would decrease by more
 9 than surcharges would increase. There is no theoretical or empirical foundation for this
 10 assertion, and it fails to take into account the complexity of bundled pricing associated with
 11 deposit accounts.

12 11. Banks offer bundles of services – *e.g.*, a checking account will commonly allow the
 13 consumer access to teller services at bank branches, check writing on her account, ATM
 14 services, debit card services, etc. Banks do not price each of these services separately, in part
 15 because much of the bank's revenue comes in the form of the difference between the return it
 16 earns on funds deposited versus the interest (if any) it pays, and in part because they set specific
 17 fees (and waive them) to attract and retain particular kinds of customers.

18 12. Decisions as to the level of foreign ATM fees and when to waive them are part of the
 19 bank's overall strategy in offering bundles of services to attract and retain customers.¹⁰ Contrary
 20 to Dr. Bamberger's assumption, the interchange fee is not, in general, a cost item that is directly
 21 passed through to foreign fees.¹¹ One clear illustration of this is that foreign fees are waived for

22
 23 ⁹ As I discuss below, I do not believe that Dr. Bamberger has shown the existence of any sort
 24 of problem here. Dr. Bamberger seems to believe it would be permissible for two small
 25 banks without market power to set positive interchange fees for transactions involving their
 26 cardholders and ATMs. Bamberger Deposition at 94:10-23. But he does not explain why
 the same positive interchange fee would be anticompetitive, as he argues, if it were set by a
 proprietary network composed entirely small banks that lack, individually or collectively,
 market power.

27 ¹⁰ Bamberger Deposition at 52:7-23; Declaration of Kerry Brashears, August 1, 2007, at ¶ 10.

28 ¹¹ [REDACTED]

1 some types of accounts.¹² More generally, because banks set the whole bundle of fees with a
 2 range of strategic objectives in mind, there is no reason to believe that a decrease in interchange
 3 fees would necessarily result in a greater or even a comparable decrease in foreign fees. Banks
 4 that use foreign fees to discourage use of competitors' branches or as a revenue source might
 5 leave them at current levels for some or all customers.

6 13. On the other hand, if all ATM network interchange fees are set at zero, surcharges
 7 will increase and the number of available ATMs will decline.¹³ ATM owners do not engage in
 8 bundled pricing to customers who are not account-holders; the ATM owners simply offer them
 9 specific services at specified prices. There are only two significant revenue streams associated
 10 with foreign ATM transactions — surcharges and interchange fees. Eliminating all interchange
 11 fee revenues would reduce these revenues by roughly a third and thus make current levels of
 12 ATM deployment unprofitable without corresponding increases in surcharges. The Chief
 13 Operating Officer at Cardtronics, the largest ISO in the United States, testified that in response to
 14 a shift from a positive interchange fee to a zero interchange fee, Cardtronics would raise
 15 surcharges by at least the amount of the pre-existing interchange fee, and that if Cardtronics
 16 could not raise surcharges, it would be out of business.¹⁴ He stated that the increase might in fact
 17 be greater than the amount of the interchange fee to make up for the portion it would have to
 18 share in cases where it is contractually required to share the surcharge with the merchant at
 19 which the ATM is installed.¹⁵ If there were contractual prohibitions on raising the surcharge or
 20 if the ATM would not be profitable even with an increased surcharge, then Cardtronics would
 21 pull the ATM from the location.¹⁶

22

23

24

¹² See Schmalensee Declaration at ¶ 47.

25

¹³ Dr. Bamberger presents no systematic analysis of what would happen to Star, the defendant banks, consumers, or the overall market if Star alone moved to zero interchange. As I have shown, Star likely would have been forced out of business.

26

¹⁴ Deposition of Michael H. Clinard, October 16, 2007 ("Clinard Deposition"), at 62:9-63:5.

27

¹⁵ Clinard Deposition at 63:21-64:9.

28

¹⁶ Clinard Deposition at 62:9-13.

1 14. Neither theory nor fact supports Dr. Bamberger's assertion that setting all ATM
 2 networks' interchange fees at zero would benefit consumers. If interchange fees decrease from
 3 50 cents to zero, it is likely that surcharges will increase significantly. ATM deployment will
 4 also likely decline. On the other hand, because of the complex considerations involved in banks'
 5 pricing to depository customers (in contrast to ATM owners' pricing for foreign transactions),
 6 there is no theoretical or empirical support for the proposition that the decrease in foreign fees, if
 7 any, would exceed the increase in surcharges, as must be the case for Dr. Bamberger's theory of
 8 harm to hold. At a minimum, those customers who do not pay foreign fees would be harmed, as
 9 they would pay higher surcharges without any offset in foreign fees.

10 15. Dr. Bamberger's discussion of no-surcharge networks ignores this fact—he argues
 11 that consumers still would benefit from a change from a no-surcharge to a "low surcharge"
 12 network if there were a more-than-offsetting decrease in foreign fees. But consumers who do not
 13 pay foreign fees would be unambiguously worse off with a "low surcharge" network.
 14 Dr. Bamberger offers no support for his assumption that consumers whose banks participate in
 15 surcharge-free networks still pay foreign ATM fees, and this assumption is inaccurate.¹⁷

16 **3. Cardholder sensitivity to foreign fees versus surcharges**

17 16. Even accepting, for the sake of argument, Dr. Bamberger's flawed assumption that
 18 changes in interchange fees directly and predictably affect foreign fees, his theory of harm still
 19 lacks validity. Specifically, his theory depends critically on the assumption that consumers are
 20 more sensitive to ATM surcharges than to foreign fees and that, as a result, banks could not raise
 21 surcharges to recapture the revenue they would lose from the foreign fee reductions he
 22 hypothesizes. If, in fact, there were no clear difference in consumer sensitivity to foreign fees
 23 versus surcharges, or consumers were more sensitive to foreign fees, then, even accepting all of

24
 25
 26 17 For examples of banking institutions that advertise free ATM withdrawals—no surcharge or
 27 foreign fees, see: <http://www.monroebank.com/contact/allianceone.html>;
<https://www.aacreditunion.org/checking-compare.asp>;
http://www.navyfcu.org/access/atmfee_rebates.html; http://www.jfcu.org/contact_ATM.asp;
<http://home.ingdirect.com/products/products.asp?s=ElectricOrange>.

1 Dr. Bamberger's other assumptions, positive interchange fees would not result in a higher overall
 2 price for foreign ATM transactions.

3 17. Dr. Bamberger claims that "[b]ecause the surcharge amount is displayed with every
 4 potential transaction, but the foreign fee is not, cardholders can be expected to be more sensitive
 5 to changes in surcharges than to foreign fees."¹⁸ This conclusion does not follow, however, for
 6 several reasons.

7 18. First, as Dr. Bamberger acknowledged in his deposition, awareness is not the same as
 8 sensitivity.¹⁹ A consumer may be aware of the surcharge at a given ATM but be relatively
 9 insensitive to it, especially if the alternatives are unknown or costly. Standing in front of an
 10 ATM in an emergency in a strange city, for instance, one may be insensitive to the displayed
 11 surcharge level because one is not aware of any nearby alternative sources of cash, let alone of
 12 the surcharges they might impose. Being unwilling to incur the sometimes substantial
 13 transactions costs of searching for other ATMs and learning their surcharges, the consumer may
 14 be aware of but insensitive to the particular surcharge she faces. Finally, even if a consumer
 15 somehow were aware of the locations and surcharges of all nearby ATMs, her behavior might be
 16 insensitive to changes in the surcharge on any particular machine, simply because the cost in
 17 time and effort of traveling to an alternative machine could easily outweigh moderate differences
 18 in surcharges. Despite all these familiar facts, Dr. Bamberger's analysis of sensitivity to
 19 surcharges starts and stops with the consumer's awareness of the surcharge of a single machine.

20 19. The [REDACTED] document that Dr. Bamberger relied on for his claim that
 21 cardholders were relatively unaware of foreign fees stated that [REDACTED]
 22 [REDACTED]
 23 [REDACTED]
 24 [REDACTED]

25
 26¹⁸ Bamberger Declaration at ¶ 13 (footnote omitted).

27¹⁹ Bamberger Deposition at 249:19-25. Professor Dhar's submission addresses only awareness
 28 of foreign fees versus surcharges. Professor Dhar assumes that awareness is the same as
 sensitivity but does not provide any support for this conclusion. For the reasons I discuss,
 consumers may be aware of surcharges but not necessarily be sensitive to them.

1 [REDACTED] ²⁰ Similarly, while some cardholders might
 2 have been aware of surcharges but not of foreign fees, they would not have been any more
 3 sensitive to surcharges because they needed the money for an emergency.

4 20. Second, a review of the documents relied on by Dr. Bamberger illustrates the lack of
 5 a sound empirical basis for his claim that cardholders are relatively unaware of ATM foreign
 6 fees. The [REDACTED] document Dr. Bamberger relied on for information [REDACTED]
 7 [REDACTED]
 8 [REDACTED]

9 [REDACTED] It is well known that it is generally not necessary for
 10 all consumers in a market to be well-informed regarding prices in order for the total market
 11 demand to be price-sensitive and thus to discipline sellers' price determinations. If these
 12 "heavy" users are aware of and sensitive to the level of foreign fees, total demand may well be
 13 price-sensitive, even if some other consumers are unaware of and thus unresponsive to foreign
 14 fees. Thus this document, relied on by Dr. Bamberger, does not imply a significant difference
 15 between cardholder sensitivity to foreign fees versus surcharges.²¹

16 21. Third, one document relied on by Dr. Bamberger for his claim that cardholders are
 17 more sensitive to surcharges than foreign fees clearly contradicts his claims. He cites the [REDACTED]
 18 [REDACTED] as stating that "[a]lthough demand for ATM cash withdrawals has proved
 19 relatively inelastic to date," 55 percent of deployers experienced a decline in on-premise ATM
 20 volume after a surcharge increase, and 50 percent experienced a decline in off-premise ATM
 21

22 20 [REDACTED]
 23 See also Bamberger Declaration at fn. 15.

24 21 Dr. Bamberger also relies on a [REDACTED] which is a study of *awareness* of foreign fees and
 25 is therefore not necessarily informative on *sensitivity* to foreign fees. [REDACTED]

26 [REDACTED] Even as a study of awareness, it is flawed—while the relevant question was
 27 intended to be asked about an ATM network's (e.g., [REDACTED]) signage on foreign ATM
 28 transactions, it is clear that many consumers thought instead that they were being asked about
 their bank's signage. Thus, what Dr. Bamberger took as a mistaken belief by consumers that
 foreign transactions on *their* bank's ATM network would not incur a foreign fee, may have
 been an accurate belief that a transaction on their own bank's ATMs would not incur a
 foreign fee.

1 volume.”²² This study reaches the conclusion that demand has been “relatively inelastic”—that
 2 is, consumers are relatively insensitive to surcharges, the opposite of what Dr. Bamberger
 3 claims. The fact that there was some decline at a given ATM following an increase in surcharges
 4 says nothing more than that there is some cardholder sensitivity to surcharges, not that there is a
 5 greater sensitivity to surcharges than to foreign fees.²³

6 22. Fourth, the only document relied on by Dr. Bamberger regarding the sensitivity of
 7 cardholders to foreign fees was a [REDACTED] document that he cited for the proposition
 8 that [REDACTED]²⁴ It
 9 does not support his assumption regarding differences in price sensitivity. He did not cite but
 10 acknowledged at deposition that this study showed that [REDACTED]
 11 [REDACTED] That is, consumers do use
 12 foreign ATMs less when foreign fees are higher. He offered no analysis to suggest that this
 13 sensitivity was less than the sensitivity of cardholders to surcharges.

14 23. Fifth, Dr. Bamberger fails to discuss that cardholder sensitivity to foreign fees has an
 15 important dimension not present in cardholder sensitivity to surcharges. In setting a foreign fee,
 16 banks need to and do consider the possibility that not only would a higher foreign fee discourage
 17 usage of foreign ATMs but also that the customer may terminate her account with the bank.²⁵
 18 The likelihood that a consumer would terminate her account as a result of foreign fees may be
 19 relatively low, but the cost to the bank if she does is quite high because the bank then would lose
 20 all of the revenue associated with the account. This imposes a further constraint on the setting of
 21
 22
 23

24 22 Bamberger Declaration at ¶15, citing [REDACTED] [STAR
 25 00124739, STAR 00124738].

26 23 [REDACTED] [STAR 00124738].

27 24 Bamberger Declaration at ¶ 14.

28 25 Dr. Bamberger acknowledged at deposition that this was a factor that banks would be
 expected to and do consider. Bamberger Deposition at 67:20-68:16. His analysis, however,
 ignores its implications.

1 foreign fees that does not apply generally to surcharges.²⁶ This consideration is important
 2 because banks typically waive foreign fees for the customers who on average they most want to
 3 attract and retain: those who maintain high account balances. Waiving foreign fees is rational
 4 only if these customers are sufficiently sensitive to the level of those fees.

5 24. Sixth, as I discussed above and as Dr. Bamberger recognizes, banks set a bundle of
 6 fees to their depository customers, not only the foreign fee in isolation. All else equal, if
 7 interchange fees were lowered to zero, banks' costs associated with customers who make foreign
 8 ATM transactions would be lower. If a bank wanted to change its pricing in response to such a
 9 change or, for example, to an increase in its tellers' wages, it likely would review the entire
 10 bundle of terms it offers its customers, including the interest rate it pays for deposits. Without
 11 knowing consumer responsiveness to these other terms, it is not possible to know the degree to
 12 which overall prices to depository account consumers would decrease, or to know whether that
 13 change would exceed or fall short of the likely increase in surcharges resulting from a decline in
 14 interchange fees.

15 25. Seventh, if Dr. Bamberger's assumptions about bank pricing behavior and
 16 consumers' relative sensitivity to foreign fees and surcharges were correct, we would expect
 17 foreign fees to exceed surcharges significantly on average.²⁷ In fact, we see the opposite. One
 18 estimate placed average foreign fees at \$1.27 and average surcharges at \$1.77 in 2005.

19 **4. Dr. Bamberger's numerical examples depend critically on
 20 flawed assumptions**

21 26. Dr. Bamberger's numerical example purporting to show that "individual network
 22 members—even 'net issuers'—can be expected to benefit from network-mandated interchange

23 26 Surcharges are, by definition, paid by cardholders that are not customers of the bank setting
 24 the surcharge. The bank therefore does not have to worry about its customers terminating
 25 their accounts in response to its own surcharges.

26 27 Ignoring bundled pricing, as Dr. Bamberger does, it is a basic textbook proposition that
 27 (a) the less price-sensitive are buyers and (b) the higher is the marginal cost, then the higher
 28 is the profit-maximizing price. Here, (a) Dr. Bamberger assumes that consumers are less
 29 sensitive to foreign fees than to surcharges and (b) interchange fees, coupled with the high
 30 fixed-cost nature of ATMs, mean that marginal cost is higher for foreign fees than for
 31 surcharges. For both of these reasons, Dr. Bamberger's theory predicts that foreign fees
 32 should exceed surcharges, but they do not.

1 fees" relies on the flawed assumptions discussed above.²⁸ If for the sake of argument we retain
 2 all of the assumptions of Dr. Bamberger's example but suppose that the impacts on foreign fees
 3 and surcharges are equal and less than the textbook ideal of full pass-through, then the
 4 conclusion of his example is reversed: His hypothetical bank is worse off because of the
 5 increase in interchange fees.²⁹

6 27. Dr Bamberger goes on to argue that the existence of ISOs, which receive interchange
 7 fees but do not pay them, is not inconsistent with his assertion that Star's (non-ISO) members
 8 were nonetheless more profitable paying positive interchange fees than they would have been
 9 with zero fees. Plaintiffs claim that "While ISOs own or control approximately 50 percent of the
 10 ATM machines, they account for only 10 percent of the transactions at ATMs." Plaintiffs cite
 11 [REDACTED]

12 [REDACTED] But the ISOs' share of foreign transactions alone is the measure that is relevant for
 13 assessing the importance of ISOs to ATM networks, as all *network* transactions are foreign
 14 transactions. That share is around [REDACTED]³⁰ Thus almost [REDACTED] percent of
 15 interchange fee payments go to ISOs, and it is difficult to imagine any real-world cartel
 16

17
 18
 19²⁸ See Dr. Bamberger's example in Bamberger Declaration ¶¶ 19-20.

20²⁹ The individual bank in Dr. Bamberger's example has revenues of \$335,000 with a zero
 21 interchange fee, a foreign fee of \$2.00 and a surcharge of \$1.50. Increasing the interchange
 22 fee to \$0.50, as Dr. Bamberger assumes, raises costs on the issuer side by \$0.50 and
 23 effectively lowers costs on the ATM owner side by \$0.50. If \$0.25, or half of the change in
 24 costs, is passed through on each side, that would result in a foreign fee of \$2.25 and a
 25 surcharge of \$1.25. Under this assumption, the bank would have revenues of only \$332,500
 26 (\$2.25 foreign fee * 100,000 transactions by its cardholders + \$1.25 surcharge * 90,000
 27 transactions by other banks' cardholder - \$0.50 interchange fee * 100,000 transactions by its
 28 cardholders + \$0.50 interchange fee * 90,000 transactions by other banks' cardholders). The
 29 bank would lose \$2,500 from the change to a \$0.50 interchange fee.

30 The study provides estimates of the number of foreign transactions for three types of ATMs
 31 (bank-owned on-premise, bank-owned off-premise, and ISO-owned) and the number of each
 32 type of ATM. Multiplying these figures for each type of ATM gives an estimate of the total
 33 number of foreign transaction for each type. The percentage reported is the estimated
 34 number of foreign ATM transactions at ISOs divided by the total number of foreign ATM
 35 transactions for all ATM types. See [REDACTED]

1 conspiring to raise its own costs in order to send almost █ percent of those costs to non-
 2 members.

3

4 **III. The Ability of an ATM Network to Set Non-Zero Interchange Fees Offers
 Significant Efficiencies, Which Would Be Lost in Dr. Bamberger's But-For World**

5 **A. Dr. Bamberger's Discussion of Neutrality Is Misleading and Flawed—The
 6 Ability of an ATM Network to Set Non-Zero Interchange Fees Allows It to
 Balance the Interests on Both Sides of the Network**

7 28. Dr. Bamberger criticizes me for failing to discuss the concept of neutrality and why it
 8 does not hold in ATM networks. He defines "neutrality" as a world in which the level of
 9 interchange fees has no effect on the price of a foreign ATM transaction, the number of foreign
 10 ATM transactions, or the profits earned by each member of an ATM network.³¹ I did not discuss
 11 neutrality expressly because it is an abstract notion, unrelated to observed realities. Indeed,
 12 Dr. Bamberger acknowledged that there are no real-world industries characterized by
 13 neutrality.³²

14 29. Of course, a key point in my prior declaration is that interchange fees are important in
 15 allowing ATM networks to attract the right balance of issuers and ATM owners—in other words,
 16 that ATM interchange fees are not neutral. Dr. Bamberger acknowledged at deposition that there
 17 are many reasons (beyond the sole reason offered in his declaration) why neutrality does not hold
 18 in ATM networks.³³ The theoretical discussion of neutrality in Dr. Bamberger's declaration adds
 19 nothing to the economic analysis of network-wide interchange fees.

20

21

22 ³¹ Bamberger Declaration at ¶¶ 29-30. I would add to his definition that the level of
 23 interchange fees do not affect any relevant economic variables (besides surcharges and
 24 foreign fees), including the number, location and ownership of ATMs.

25 ³² Bamberger Deposition at 227:2-5.

26 ³³ Dr. Bamberger argued in his declaration that non-neutrality flows solely from consumers
 27 allegedly being more sensitive to surcharges than foreign fees. At deposition he
 28 acknowledged a wide range of additional conditions in ATM networks that violate neutrality:
 e.g., the possibility there is no one-for-one pass-through of interchange fees; foreign fee
 waivers; bundled pricing of depository accounts; differential attractiveness of ATM
 locations; search costs for consumers in finding ATMs; and transactions costs for consumer
 in comparing surcharges. *Compare* Bamberger Declaration at ¶31 with Bamberger
 Deposition at 165:16- 167:1, 42:12-17, 139:9-16, 102:3-7, 103:17-25 & 104:1-6.

1 30. Dr. Bamberger also criticizes my discussion of how interchange fees serve as an
 2 instrument ATM networks use to balance the two sides of the network. He argues that while the
 3 economic literature concerning two-sided markets may apply to credit card networks, it does not
 4 apply to ATM networks.³⁴ That is incorrect. First, as Dr. Bamberger acknowledges, interchange
 5 fees play a role in attracting members to the network (that is why, he believes, proprietary
 6 systems set positive interchange fees).³⁵ Dr. Bamberger contends that interchange fees are,
 7 nevertheless, not important to a network in balancing the interests of issuers and ATM owners
 8 because ATM owners can obtain compensation through surcharges. Surcharges, however, are
 9 set independently by ATM owners. They cannot be used by the network to balance interests.
 10 Second, Dr. Bamberger is incorrect in claiming that the economic literature on two-sided
 11 markets—and the economic rationale of using interchange fees to balance the two sides—does
 12 not apply to ATM networks because “both ‘sides’ of the transaction levy a fee on the same
 13 economic actor . . . the cardholder for the same transaction.” The economic literature on two-
 14 sided platforms recognizes many industries in which the two sides ultimately levy all fees on the
 15 same economic actors. Computer operating systems, for example, are widely agreed to be two-
 16 sided platforms because they connect end users of computers and third-party vendors that sell
 17 products (such as application software or peripherals) that depend on the operating system.
 18 Other examples of two-sided platforms where there is only one ultimate end user include media
 19 such as magazines or newspapers (which connect readers and advertisers), shopping malls
 20 (which connect shoppers and retailers) and video game systems (which connect gamers and
 21 video game developers). In this case, some banks (especially those with fewer of their own
 22 ATMs) may wish to pay interchange fees to ATM owners in order to lower the surcharges their
 23 consumers face, and to increase the ATMs available to them, even though there is only one
 24 end user.

25

26

27

28

³⁴ Bamberger Declaration at ¶ 41-46.

³⁵ Bamberger Declaration at ¶ 52.

1 **B. Dr. Bamberger Ignores the Importance of Inter-Network Competition by**
 2 **Simply Assuming That No ATM Network Could Ever Legally Adopt a**
 3 **Positive Interchange Fee**

4 31. Dr. Bamberger states in his declaration that “I understand that plaintiffs contend that
 5 proprietary networks that set a positive interchange fee facilitate collective price setting by
 6 network members.”³⁶ It is not clear whether he agrees with this contention, but he assumes for
 7 the purposes of his analysis that no ATM network, regardless of ownership structure, can adopt a
 8 positive interchange fee. By doing so, he simply assumes away the importance of inter-network
 9 competition. When this competition is taken into account, it is clear that a positive interchange
 10 fee offers significant procompetitive benefits because it allows ATM networks to attract ATMs
 11 and thereby expand output. Two examples illustrate this general point.

12 32. First, an ATM network that is unable to offer attractive interchange fees to ATM
 13 owners would likely have significant difficulty attracting ATMs to the network. Specifically, a
 14 network with zero interchange fees would be substantially less attractive to an ATM owner if
 15 other networks were permitted to offer positive interchange fees. If Star were required to set its
 16 interchange fee at zero, while other ATM networks were allowed to freely set interchange fees, it
 17 would be difficult if not impossible for Star to attract ATM owners, especially ISOs. It does not
 18 seem likely that Star thus handicapped could survive.

19 33. Second, Dr. Bamberger ignores the evidence that ATM networks use interchange fees
 20 to compete with each other in attracting ATM deployers generally, and ISOs in particular.
 21 Dr. Bamberger gives no weight to evidence that ATM networks view higher interchange fees as
 22 more attractive to ISOs. The [REDACTED] ATM network, for example, adopted a “split” interchange
 23 fee structure in 2000, with different fees for on-premises and off-premises machines, in order to
 24 encourage ISOs to join its network.³⁷ More recently, Plus made a substantial adjustment to its
 25 interchange fee levels to encourage the deployment of advanced-function ATMs.³⁸
 26 Dr. Bamberger also ignores evidence that, contrary to his hypothesis, lower interchange fees

27

 28 ³⁶ Bamberger Declaration at fn. 58.

29 ³⁷ [REDACTED]

30 ³⁸ Declaration of Alan Pohlman, December 20, 2007, at fn. 35.

1 were more attractive to net issuers (at least when considering small changes not likely to affect
 2 ATM deployment significantly).³⁹ Plaintiffs' own expert, Mr. Pohlman, stated in 1997 that the
 3 interchange fee structure "can have a significant impact on the competitive environment between
 4 regional networks."⁴⁰

5 **C. Dr. Bamberger's Proposed World Would Eliminate the Significant
 6 Procompetitive Benefits of Positive Interchange Fees**

7 34. In Dr. Bamberger's proposed world, no ATM network would be permitted to set a
 8 positive interchange fee. We have no experience with this world. In the actual world, competing
 9 ATM networks, all with positive interchange fees, have provided enormous benefits to
 10 consumers. Dr. Bamberger would seek to change the structure of this industry fundamentally by
 11 mandating zero interchange fees for all ATM networks. Such a world would have fewer ATMs
 12 available to consumers than there are today, and output would be lower.

13 35. Business practices that, under competition, increase output should be viewed as
 14 presumptively procompetitive. In his declaration, Dr. Bamberger argued that I did not conclude
 15 that interchange fees increased output.⁴¹ In fact, I clearly stated and explained why positive
 16 interchange fees *are* likely to increase output.⁴² Having more ATMs, for example, offers
 17 consumers greater convenience. While those ATMs come with additional costs, just as
 18 competition among banks may result in more branches that come with additional costs, it is not
 19 generally desirable to use the antitrust laws to regulate the competitive choices of firms,
 20 especially when they increase output.

21 36. Along with fewer ATMs and lower output, Dr. Bamberger's but-for world would
 22 also have higher surcharges to consumers (*see* paragraphs 13-14 above). A move from no-
 23 surcharge networks to the "low-surcharge" networks posited by Dr. Bamberger also would harm
 24 consumers of those networks who do not pay foreign fees. Any ATM networks that existed

25
 39

26 40 Deposition of Alan Pohlman, February 10, 2008, Exhibit 718, "Surcharge Speech," at 6
 27 [PLTF-044705].

28 41 Bamberger Declaration at ¶ 40.

42 *See, e.g.*, Schmalensee Declaration, at ¶¶ 20, 51-60.

1 would be unable to offer depository customers the level of convenience, as ATM networks
2 would be smaller; and it would have higher average costs, as ATM networks would lose scale
3 efficiencies.⁴³ Banks that use foreign fees to discourage use of competitors' branches or as a
4 revenue source might leave them at current levels for some or all customers, so their consumers
5 would have no offsetting benefit from lower foreign fees. Dr. Bamberger's world of regulated
6 interchange fees would therefore result in a significant, perhaps enormous, loss of consumer
7 benefits.

8 37. I declare under penalty of perjury under the laws of the United States of America that
9 the foregoing is true and correct. Executed in San Diego, California on February 21, 2008.

10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27

965252


Richard Schmalensee

Richard Schmalensee

⁴³ Dr. Bamberger acknowledges the existence of scale economies in ATM networks. Bamberger Deposition at 234:23-25.